



AUDIT OF
LEASED SPACE
MANAGEMENT PRACTICES

**From The Office Of State Auditor
Claire McCaskill**

Report No. 2000-122
December 5, 2000

Leasing operations are effectively managed, and
with a few enhancements could be more effective.

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PERFORMANCE AUDIT



Office Of The
State Auditor Of Missouri
Claire McCaskill

December 2000

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Management of leased space was effective and with some enhancements could be more effective.

This report addresses the State Auditor's Office assessment of whether Division of Facility Management (DFM) officials have provided effective oversight over the leasing of office space for state agencies and whether agency officials have been encouraged to support the economic development of inner cities through the leasing of office space.

Leasing personnel have successfully used the formal bid, informal bid, or negotiated methods in determining agency lease rates. Our review disclosed that there are some opportunities to improve operations. Currently, leasing personnel are not required to perform market analyses to determine fair market rental rates, nor are they required to document results when negotiating lease renewals or new leases. The lack of market analyses of lease areas under consideration and lack of documented negotiation results raised questions as to whether leasing officials could be assured the lowest possible lease rates were achieved.

Community-based actions challenging leasing decisions have led to delays and changes in leasing decisions. Audit results showed examples where community activists resisted agency placements in the community or agency relocations to another community. In one example, leasing officials attempted to consolidate several agencies at one location, but, community activists succeeded in preventing one agency from relocating out of the community into the new consolidated space in a different community. As a result, two locations are necessary and the state will incur an additional \$268,835 in leasing costs over the next 5 years.

DFM leasing officials have allowed agency officials to fund unique requirements and major renovations to agency leased space through lease payments rather than from agency funds. As a result, lease costs, renovation costs, and the potential for shortfalls in lease funding have increased. For example, one lease will cost the state an estimated additional \$406,000 over the next 10 years because leasing officials allowed unique requirements and major renovations to be paid by the lease. DFM leasing officials now believe unique requirements and major renovations should have been paid out of agency operating funds and are taking action to stop this practice.

(over)

YET LOW SHEET

The state does not have a policy, and leasing officials do not have any guidance addressing locating leased state offices in the inner city as a means of supporting the economic development of those cities. Our review of rationale used by most agency officials for locating leased space in the St. Louis and Kansas City metropolitan areas showed the reasons for locating office space outside these cities were justified. Some agency officials did not have compelling reasons for placing offices outside the city. By locating state agencies in the inner cities, inner cities stand to gain the benefits associated with having additional workers in the city and enhanced employment opportunities that state agencies afford.

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CLAIRE C. McCASKILL
Missouri State Auditor

Honorable Roger Wilson, Governor
Members of the General Assembly
Commissioner, Office of Administration
Director, Division of Facilities Management

The State Auditor's Office performed an audit of the management of leased space by the Office of Administration, Division of Facilities Management (DFM), Facilities Leasing Section (FLS). FLS officials manage leases for most state agencies and are responsible for the acquisition of necessary space through the lease process. Audit objectives included determining whether leasing officials have provided appropriate oversight over the leasing of office space for state agencies, and whether agency officials have been encouraged to support the economic development of inner cities through the leasing of office space.

We determined that management of leasing operations was effective. FLS officials successfully used the formal bid, informal bid, or negotiated methods to determine agency lease rates. However, with some enhancements, management officials could be more effective. Leasing policies and procedures do not require leasing personnel to perform market analyses or document negotiation results, and community activists are influencing leasing decisions. In addition, lease rates are increasing because unique agency requirements are being funded through lease agreements rather than agency operating funds. Moreover, the state has no policy on locating leased state offices in the inner cities as a means of supporting the economic development of those cities.

We concluded that DFM officials could improve their operations by: (1) performing market analyses of lease areas under consideration and documenting negotiation results; (2) preplanning for community activists when sensitive leases are being planned; (3) strengthening its guidance concerning base rental rates and one time payments, and (4) requiring agencies to fund unique requirements and major renovations out of agency operating funds.

In addition, inner cities could gain the benefits associated with having additional workers and enhanced employment opportunities that state agencies afford, by locating state agencies in the inner cities.

Claire McCaskill
State Auditor

October 6, 2000 (fieldwork completion date)

The following auditors participated in the preparation of this report:

Director of Audits:	William D. Miller, CIA
Audit Manager:	Robert D. Spence, CGFM
In-Charge Auditor:	Karen A. Wolf
Audit Staff:	Douglas P. Robinson
	A. Dailey

RESULTS AND RECOMMENDATIONS

1. DFM Provides Effective Oversight of Leasing Operations and, with Some Enhancements, DFM Could Be More Effective

Our review of 35 of 451 office leases showed that FLS officials provide effective oversight of leasing operations. Leasing personnel successfully use the formal bid, informal bid, or negotiated methods to determine agency lease rates. However, leasing personnel could improve operations by (i) performing market analyses to determine fair market rental rates; (ii) documenting results when negotiating lease renewals or new leases; and (iii) preplanning for community activists when sensitive leases are being planned. Our review of leasing policies, procedures, and active leases disclosed that

- leasing personnel are not required to conduct a market analysis of areas under consideration by agencies or to document negotiation results; and
- community activists can influence decisions about placing an agency in the community or to move an agency to another community.

The lack of a market analysis of lease areas under consideration and lack of documented negotiation results, raises questions as to whether FLS officials can be assured the lowest possible lease rates are obtained. In addition, community action to influence the placement of agency lease space causes delays in obtaining lease space for agencies and in some cases, causes the state to incur additional lease costs.

Background

The FLS is an integral part of the DFM and is responsible for leased property acquired for use by selected agencies statewide. Leasing officials establish policies and procedures governing the acquisition and management of leased property. The competitive bid process is the state's primary method for the acquisition of leased real property. The competitive bid process involves publicly advertising the terms, conditions, and requirements of a lease and receiving sealed bids which are evaluated. However, FLS policies also allow exceptions to the formal bid process when deemed in the best interest of the state to pursue another process. This occurs usually when the agency needs to expedite obtaining a new lease or when desiring to renew an existing lease. Leasing personnel use two methods of procurement to implement these exceptions—the informal bid process and negotiations.

The informal bid process seeks proposals from vendors without publishing and advertising for bid. They usually use a bidders list to identify vendors. The informal bid process does not require bidders to submit a bid or performance bond, and may not require sealed plans to be submitted.

The negotiation process requires leasing officials to negotiate with prospective landlords to secure the best and most proper terms and conditions.

Leasing personnel follow policies and procedures

Our review of 35 leases disclosed that leasing personnel followed policies and procedures for procuring leased space for state agencies. Of the 35 leases reviewed, 16 were competitively bid, 3 were informally bid and 16 were negotiated. A description of our results follows.

Competitive Bids: Leasing personnel reviewed space requirements, notified potential interested parties, and advertised requirements. They opened and reviewed sealed bids submitted to FLS. A review committee of leasing and agency personnel, evaluated bids with 75 percent of the evaluation based on price and 25 percent based on subjective factors.

Leases were
bid properly

Informal Bids: Leasing personnel selected bidders from whom to solicit bids, reviewed the bids, and selected the winning bidder.

Negotiated Leases: Leasing personnel conducted negotiations and received reasonable lease rates.

Negotiation process lacks market analysis and documented results

Although leasing personnel followed procedures, formal market analyses were not performed to determine the reasonableness of proposed lease rates. FLS procedures did not require a formal market analysis of lease rates. Instead, leasing officials depended on the expertise of area leasing coordinators to know lease rates for the areas under their jurisdiction. The area coordinators based their knowledge on other state lease rates in the area or discussions with local realtors in the area under consideration. A periodic market analysis should be made to ensure that prevailing lease rates are identified and documented to augment the expertise of the area coordinators. This market analysis could be used to evaluate the decisions made by the area coordinators and to expose deviations from prevailing rates. Accordingly, appropriate justifications for deviations could be reviewed and analyzed.

Lease
documentation
lacks audit
trail

We did not find evidence of the negotiations for 13 of the 16 negotiated leases included in our audit. Negotiations were conducted informally, and FLS procedures did not require leasing personnel to document results of the negotiations. Lease coordinators conducted negotiations by telephone, e-mail, or through face-to-face conversations with potential landlords. Leasing coordinators conducted negotiations, and the leasing manager or Assistant Director made final decisions on the reasonableness of lease rates or whether additional negotiations were necessary. For 3 of the 16 leases, we found some evidence of negotiations such as memos in which the landlord or his representative and leasing personnel discussed desired improvements and potential lease costs for the renewed lease.

The lease rates for the 35 leases in our audit were reasonable and comparable to rates in the areas where the leases were located. Therefore, there was not any adverse immediate

effect from the lack of documentation discussed above. However, without appropriate documentation and audit trail, there is no assurance that future leases will meet prevailing rates, or that FLS management will have the appropriate management tools to determine the appropriateness of lease rates.

Leasing decisions have been impacted by community actions that caused delays and increased lease costs

According to FLS officials, leasing decisions have been impacted because some community activists resisted the placement of state agency offices in neighborhoods, or other community activists sought to have agencies locate or stay in their communities. This community activism generally would lead to complaints to state legislators who took action to assist the communities in defeating the placement of agencies in their community or helping them keep agencies within their communities.

Community
activists
caused delays

In two cases, constituents did not support the proposed inclusion of probation and parole offices in local neighborhoods. Community activists complained to state representatives and state representatives interceded on their behalf. In these cases, leasing officials accommodated the community and legislative representatives by relocating these offices. Although the total cost impact of these moves is not yet known, relocating one of the probation and parole offices with 16,580 square feet is expected to increase the original cost per square foot by \$1.18, or an additional \$205,000 in leasing costs over the next 10.5 years.

In another case, community leaders resisted the state's plan to consolidate agencies in one location by relocating agency offices from two geographic locations into one. Leasing officials awarded a contract through the formal bid process that would have required the office located in one community to relocate to another community. The successful bidder quoted a lease rate of \$7.89 a square foot for the total 29,538 square feet of office space required. Community activists from the losing community succeeded in stopping the move until leasing officials agreed to locate one office within the community's boundaries. As a result, the state had to award leases in two locations instead of one. This increased the total lease cost for space by \$53,767. These lease changes caused one agency to extend a lease because new space was not available at an additional annual cost of \$20,000. Since two leases had to be awarded in two locations, the total square footage required for office space increased by 29 square feet at a cost of \$53,767.

Comparison of Lease Decisions

Lease	Locations	Total Square Feet	Total Annual Cost
Original Plan	Farmington	29,538	\$233,000
Revised Plan	Park Hills & Farmington	29, 568	286,767
Difference		29	53,767

The original bid of \$233,000 represented consolidated space for several agencies. Since the community activists prevailed, the state will now have to lease two buildings in different locations at higher costs. As a result, the state will incur an additional \$53,767 in leasing costs per year, or an additional \$268,835 over the next 5 years.

Community based influence on state agency space location decisions may be reduced by working more closely with affected community activists and state legislators before taking action on sensitive leases.

Recommendations

We recommend DFM officials strengthen oversight of leasing operations by directing FLS officials to:

- 1.1 perform market analyses of lease locations under consideration and document negotiation results; and
- 1.2 work more closely with communities and legislators in planning where to locate certain agencies in communities prior to initiating the leasing process.

Office of Administration Comments

The Director, Division of Facilities Management agreed with the recommendations and provided acceptable implementation plans. Specifically, he agreed to ensure that contract files contain proper documentation of negotiations and a description of the type of market place analysis that was used. The Director also agreed to work with communities and legislators prior to initiating the leasing process for locations with the caveat that care be taken to avoid undo influence on the selection and evaluation process. (See Appendix III, page 16, for detailed comments).

2. Use of Lease Funds to Pay for Unique Requirements and Major Renovations Has Increased Lease Costs

Leasing officials have allowed agencies to fund unique requirements and major renovations to agency lease space through lease payments. However, leasing officials now believe unique agency requirements and major renovations should have been paid out of agency operating funds and are taking action to stop this practice. This has occurred because leasing

- officials have not been consistent in what they allowed agency officials to include as lease requirements;
- guidance did not specify what requirements should be paid with leasing funds; and
- guidance discouraged one-time payments for agency requirements from agency operating funds.

In addition, leasing officials believe agencies have included unique requirements and major renovations in lease requirements as a means of avoiding having to address those items in agency operating funds budgets.

This has resulted in

- increased lease rates;
- increased statewide average lease costs used by leasing for budget purposes; and
- potential shortfalls in lease funding.

Background

Every year, leasing personnel work with agency officials to determine leased space requirements in order to determine an overall budget for all leased space. Leasing personnel determine an average statewide lease rate for new space requirements and leases coming up for renewal. For renewals, if an agency's lease rate is above the statewide average rate, leasing officials use an assumed inflation rate of about 7 percent, which includes minor renovations of up to \$25,000, for budgeting purposes. This formulates the basis for determining the total budget needed to cover all FLS leases. The state funds lease payments out of funds authorized by House Bill 13 and that act states funds are to be used for real property leases and related services and utilities for various departments of state government.

Lease costs have increased as a result of including major renovations and unique requirements in leases

Leasing officials provided us with case examples where agency unique requirements and major renovations have contributed to increased annual lease costs. One example also demonstrates how leasing officials have been inconsistent by allowing some unique requirements to be paid

with one-time payments from the agency's operating funds while allowing other unique requirements to be included in the lease.

Of the examples, two involve probation and parole offices, one involves a youth services office, and one involves consolidating several agencies at one location.

- The original lease for a probation and parole office located in St Louis included 11,638 square feet at a price of \$11.71 per square foot. The new lease increased the square footage to 20,302 at a price of \$14.36 per square foot. Major renovations were conducted on the existing space as well as construction of the additional space. A leasing official noted that the costs of the lease, without the major renovations, would have increased only a small amount. However, based on their experience with square footage rates in the area, the official believed that at least \$2 of the \$2.65 increase could be attributed to major renovations of the existing space and some unique requirements included in the agency's request. The remaining \$.65 is attributed to inflation. As a result, this will cost the state an estimated additional \$406,000 in leasing costs over the next 10 years. Examples of unique requirements included were:

Unique
requirements
included in
lease

- safety glass windows installed at a cost of \$200 per window;
- convex mirrors installed in hallways and waiting areas;
- keyless locking system installed on staff entrances and an entrance protected from the weather; and
- a urinalysis room equipped with a chemical resistant countertop, lockable storage cabinets above the counter; a floor drain, and a keyless lock on the door.

- The original lease for a probation and parole office located in Kansas City cost \$10.85 per square foot for 5,130 square feet of office space. A leasing official noted that the building had been fire bombed and the landlord had to restore the building to original condition. Probation and parole personnel needed more space, so it was expanded to 12,341 square feet. In addition, the agency personnel requested other major renovations and unique requirements which leasing officials approved. The cost of the lease increased to \$13.81 per square foot for an increase of \$2.96 a square foot. Based on experience with square footage rates in the area, a leasing official estimated that unique requirements and major renovations accounted for approximately \$1.50 of the \$2.96 increase in cost or an additional \$130,000 cost over the next 7 years. The remaining increase can be attributed to increase in square footage and inflation.

Excess costs
caused by
state agency

- Another case involved consolidating several agencies at one location. In this example, leasing officials persuaded agencies to make a one-time payment for unique requirements from agency operating funds because leasing officials did not believe agencies should have to absorb additional costs for unique requirements of other agencies. However, leasing officials also allowed some unique requirements to be funded through the lease.

- Examples, along with cost estimates for the items paid from agency operating funds, are shown below.
 - Department of Corrections - Probation and Parole
 - Armory \$15,000
 - Urinalysis Room \$6,900
 - Glass Vision Panels \$3,791
 - Voice data and electrical changes \$983
 - Keyless locks \$1,540
 - Department of Elementary and Secondary Education - Vocational Rehabilitation
 - Pad for satellite dish \$3,791
 - Keyless locks \$1,540
 - Voice data and electrical changes \$4,943
 - Department of Elementary and Secondary Education - Disability Determinations
 - Keyless locks \$3,850
 - Door changes \$850
 - Voice data and electrical changes \$9,329
 - Department of Labor and Industrial Relations - Employment Security
 - Keyless locks \$3,080
 - Voice data and electrical changes \$1,640

Examples of unique requirements that were funded through the lease are shown below.

- Department of Labor and Industrial Relations
 - Sign identifying agency.
 - Power assisted doors
 - Special placement of lobby, restrooms and multipurpose rooms
 - Special requirements for a raised platform for a receptionist
 - Special window in the manager's office
- Department of Elementary and Secondary Education
 - Two entrance doors to interview room.
 - Higher grade door on offices
 - Special requirements to place a satellite dish
- Department of Corrections
 - Special requirements for receptionist area
 - Higher grade insulation in rooms
 - Higher grade doors to work areas

Leasing officials sought competitive bids and awarded a contract for the construction of a new building to house various state agencies. The winning bid came in at \$13.96 a square foot for the office space. When additional agencies needed space, leasing

officials decided to add 10,000 square feet of space. With the additional square footage and the inclusion of unique requirements, the lease rate increased to \$15.02 a square foot. A leasing official, based on experience with the square footage rate in the area, believed that unique requirements, such as those shown above, adversely affected the original lease rate and accounted for approximately 50 percent of the \$1.06 per square foot increase. The remaining increase can be attributed to the increase in square footage. This results in an increase in lease cost to the state of approximately \$281,000 over the 10-year lease.

Practice leads to increased budget requests and potential funding shortfalls

Although leasing officials have not determined the actual impact, they believe their practice of funding unique requirements and major renovations has contributed to the increase in average lease rates used for budgeting purposes and the latest increase to the lease budget. For example, for fiscal years 1999 through 2001, the average statewide rental rates were fairly stable at about \$11.50 to \$12.00 a square foot. However, for fiscal years 2002/2003, the average rental rate increased to \$13.50 a square foot and leasing officials used this rate in formulating the fiscal year 2002/2003 budget request for leasing.

Leasing officials also believe this practice could lead to shortfalls in lease funding. Shortfalls could occur because budget estimates are based on square footage and do not include unique requirements or major renovations. If shortfalls in lease funding occur, FLS officials will have to seek additional lease funding from the state legislature.

Guidance has been contradictory and not clear

FLS guidance states that lease funds should only pay for base rental rates, however, the guidance does not define what is included in base rental rates. In addition, FLS leasing policy is somewhat contradictory in that it also discourages making one-time payments from operating funds in order to pay for unique requirements or major renovations. FLS guidance states, in part, that DFM and the tenant agency will attempt to avoid making one-time payments and if such payments are necessary, they will be funded from the tenant agency's operating funds.

Leasing officials have also contributed to the problem by sending a mixed message to agencies. At times, leasing officials have allowed agencies to include unique requirements and major renovations in lease agreements while at other times they have insisted agency officials pay for these items with agency operating funds. (*See pages 8-9 for case examples.*)

According to leasing officials, House Bill 13 funds are intended to cover only base rental rates. However, they now recognize that legislative and leasing guidance is not clear as to what is covered in base rental rates. In October 2000, FLS officials sought advice from Office of Administration Budget officials on the appropriateness of using lease funds to pay for unique requirements and major renovations. Office of Administration Budget officials proposed that unique requirements be included in the House Bill 13 budget as separate items and that agency officials defend the requests for funding during budget hearings. If approved, the funding would be available to be used for one-time payments for unique requirements. The cost of these

improvements would no longer be included in lease agreements. According to a budget official, the Commissioner for the Office of Administration has approved this proposal and plans to submit it to the governor-elect for his consideration in the December time frame

Officials are taking action to limit practice

Leasing officials' concerns with rising rental rates, the intended use of lease funding, and potential shortfalls in lease funding has caused them to closely review unique requirements and major renovations requested in agency lease requirements. For example, for leases being renewed in calendar year 2000, leasing officials are attempting to prevent agencies from including unique requirements and major renovations in lease requirements. Instead, leasing officials hope to convince agency officials to fund those requirements out of agency operating funds.

Current action by leasing officials is encouraging

Leasing officials informed us they have several agencies they are currently dealing with that want to include unique requirements or major renovations in lease agreements. For example, one agency has 14 leases that expired on June 30, 2000. Agency officials agreed to renew the leases for another 5 years. Several landlords agreed to renew leases at the current lease rate. However, agency officials now want renovations made to the space that will result in larger than expected increases to lease rates, according to leasing officials. The following are two examples that leasing officials are trying to resolve.

- One landlord has agreed to renew the lease of 9,150 square feet of office space at the existing price of \$9.10 a square foot. With proposed renovations, the landlord wants \$12.50 a square foot—a 37.4 percent increase in the lease rate or a \$31,110 increase in cost per year.
- In another case, the agency wants to relocate most walls and other significant reconstruction done on the space. If done, the cost per square foot will increase from \$7.66 to \$10.16, which is a change of \$2.50—a 32.6 percent increase. With 9,188 square feet of office space, this means an increase of \$22,970 per year.

Leasing officials currently do not plan to allow the proposed renovations to be paid for through the lease. Instead, they plan to renew the leases and advise the agency to seek budgetary approval from the legislature for the renovations. If the agency does not agree, the dispute will likely be escalated to the Commissioner of the Office of Administration for resolution and, according to a leasing official, the Commissioner could overrule leasing officials.

Conclusions

Leasing officials' practice of allowing agencies to fund unique requirements and/or major renovations through leases has contributed to increases in lease rates and the need to increase the overall budget for state leases. If current practices continue, it is likely that budget shortfalls will

occur. In addition, the FLS policy is vague because it does not address the type of agency requirements that can be included in lease agreements, and it is contradictory because it discourages agencies from paying for unique requirements and major renovations with agency operating funds. Agencies have gotten mixed messages from leasing officials on including unique requirements and/or major renovations in lease requirements and are likely to believe it is appropriate.

Recommendations

DFM officials should direct FLS officials to:

- 2.1 clarify and strengthen its policies to ensure that leasing officials have adequate criteria to determine what can be included in lease agreements; and
- 2.2 consistently follow policies and not allow unique requirements and major renovations to be funded through leases.

Office of Administration Comments

The Director, Division of Facilities Management agreed with the recommendations and provided acceptable implementation plans. The director stated that the special agency requirements should be a separate section within the leasing budget request rather than incorporated into the agency's operating budget. The director plans to use the boilerplate office specifications as the criteria for base rental rates and any deviations by agencies will be incorporated as a separate section of the leasing budget as a one-time decision item. (See Appendix III, page 16, for detailed comments).

3. The State Is Missing an Opportunity to Support the Economic Development of Inner Cities

The state does not have a policy for locating leased state offices in the inner city as a means of supporting economic development of the inner cities. As a result, FLS does not have any guidance or policies that address this issue. Our review of the rationale for locating leased office space in the St. Louis and Kansas City metropolitan areas showed that the majority of agency officials had sound reasons for locating office space outside these cities. However, we did find that some agency officials did not have compelling reasons for placing offices outside the city. The state does not have a policy because it has not addressed this issue. By not locating state offices in the inner cities, inner cities are deprived of job opportunities, tax revenues, and other benefits.

The state does not have a policy on locating leased space in the inner city

FLS guidance allows state agency officials to determine where to locate leased space. FLS officials do not question the location of agency offices unless they believe that the agency officials have unduly restricted the area of consideration, which in turn restricts competition. Our review of lease contracts confirmed that state agency officials specified areas in which they wanted to locate offices. None of the agency leasing officials we contacted were aware of any state requirement to locate in the inner cities, nor was it a consideration in their decision making process. Our review disclosed that there was reasonable justification to support decisions for locating offices outside the city in the metropolitan Kansas City and St. Louis areas. For example, of 18 division office locations reviewed, 12 were based on a need to effectively serve clients. Agency officials considered such things as where clients live and the availability of public transportation in locating offices

We found no compelling reasons to support county office location selections for 6 of the 18 divisions. For example, several located outside the cities based on a desire to be close to major highways. However, St. Louis and Kansas City both have good access to major highways.

The federal government has addressed the issue of locating agencies in the inner cities

The federal government has a policy that encourages the development and redevelopment of cities by locating federal facilities in urban areas. In 1978, the President of the United States issued Executive Order No. 12072, that states in part, “Federal facilities and Federal use of space in urban areas shall serve to strengthen the Nation’s cities and to make them attractive places to live and work. Such Federal space shall conserve existing urban resources and encourage the development and redevelopment of cities”

Conclusion

We believe inner cities stand to gain the benefits associated with having additional workers in the city and enhanced employment opportunities that state agencies afford by locating state agencies in the inner cities.

Recommendation

We recommend:

- 3.1 the General Assembly consider establishing a policy that requires agencies, when seeking office space, to make an effort to obtain bids in urban areas unless there is a compelling reason for locating elsewhere, or maintain documentation that effort was made to negotiate space in urban areas in those instances where bids were appropriately not sought.

Office of Administration Comments

The Director, Division of Facilities Management agreed with the recommendations and provided acceptable implementation plans. The director stated that the recommendation will be explored with the new administration and the Joint Committee on Capital Improvements and Leases Oversight.

OBJECTIVE, SCOPE AND METHODOLOGY

Objectives

Our objectives included determining whether (1) leasing officials have provided appropriate oversight over the leasing of office space for state agencies; and (2) agencies have been encouraged to support the economic development of inner cities through the leasing of office space.

Scope and Methodology

To determine whether leasing officials have provided appropriate oversight, we judgmentally selected 35 of 451 office leases. The 35 leases represented new and renewed leases that were executed under leasing guidance that went into effect in August 1995. The majority of leases selected were located in metropolitan areas, such as St. Louis County, St. Louis City, Jackson County and Clay County. To accomplish our audit we reviewed

- documentation available in lease files and discussed contracts reviewed with knowledgeable officials to determine whether leasing personnel followed prescribed procedures in executing new and renewal lease contracts,
- selected contracts and contacted leasing agency representatives to ascertain the reasonableness of agency rationale used in locating agency-leased space,
- federal guidance used in locating federal agencies within the inner cities, and
- state statutes, and the code of state regulations.

We conducted our review from June through October 6, 2000. The audit was conducted in accordance with generally accepted government auditing standards.

APPENDIX II

BACKGROUND

In 1993, the state centralized leasing operations by creating the DFM under the Office of Administration. FLS officials manage leasing operations for the DFM. FLS officials manage leases for the majority of state agencies by overseeing approximately 600 contracts worth almost \$39 million, as of June 1, 2000. More specifically, FLS leases approximately 3.5 million square feet of office space at an annual cost of approximately \$35 million.

Statewide leasing operations are governed in accordance with Section 34.030 of the RSMo and 1 CSR 35-2 of the Code of State Regulations. Section 34.030 states that the commissioner of administration shall negotiate all leases, except for such departments that derive power to acquire lands from the state constitution.

1 CSR 35-2.040 establishes a uniform procedure for procuring leased real property. All acquisitions of leased property, including both newly executed leases and the extensions of existing leases after all renewal options have expired, shall be procured through publicly advertised competitive proposals, unless the commissioner of administration deems it to be in the best interest of the state to negotiate a particular procurement. For each lease, the commissioner of administration, in conjunction with the tenant/using agency, shall develop a Request for Proposal (RFP) for the property to be acquired. The commissioner of administration may suspend from bidding on state leases any individual or organization who (A) materially fails to comply with the provisions of an award from the state or a lease agreement with the state; (B) submits false or misleading information in response to an RFP; (C) takes actions that are intended to inhibit or prevent the operation of an open, competitive bid or proposal process; or (D) acts in a manner contrary to sound or ethical business practice, or in a manner deemed by the commissioner of administration to be detrimental to state leasing practice. A bidder/lessor may be required to submit a surety document payable to the state of Missouri to insure compliance with the RFP and/or lease. An evaluation of all proposals shall be conducted in accordance with the RFP. The decision to award a lease to a lessor shall be based upon the lowest and best proposal received in accordance with the terms of the RFP.

1 CSR 35-2.050(4) states that the commissioner of administration shall have the authority to make a one-time lump-sum payment to a lessor for renovations to a leased facility under the following conditions: (A) the improvements provide a direct benefit to the operations of the state's programs and are not required for the provision of any of the services covered by the lease, such as maintenance, upkeep or repair of the facility; (B) the amount paid by the commissioner for the construction of the improvements is no more than the reasonable cost to construct the improvements; and (C) the remaining term of the lease, including the lessee's options to renew, exceeds twelve months. A one-time payment may only be made in the last one year renewal period of a lease if necessary to meet unforeseen changes in program requirements.



Roger B. Wilson
Governor

Richard A. Hanson
Commissioner

State of Missouri
OFFICE OF ADMINISTRATION
3225 West Truman Boulevard, Suite 100
Jefferson City, MO 65109

Linward "Lin" Appling
Director
Division of Facilities Management
(573) 751-1003 Telephone
(573) 526-4138 Fax
dfmleasing@mail.oa.state.mo.us

MEMORANDUM

TO: William D. Miller, CIA
Director of Audits
Office of the State Auditor

FROM: Lin Appling, Director
Office of Administration
Division of Facilities Management

DATE: December 4, 2000

SUBJECT: Comments to Draft Report, "Audit of Leased Space Management Practices"

We have reviewed the draft report titled "Audit of Leased Space Management Practices," and would like to offer the following comments in regard to the recommendations:

- 1.1 Perform market analyses of lease locations under consideration and document negotiation results.

Comment: DFM concurs with the recommendation. Effective 1/1/01, the contract file for all negotiated actions will contain documentation of the negotiations that took place and a description of the type of market place analysis that was used, i.e., competitive proposals, recent public bids, etc.

- 1.2 Work more closely with communities and legislators in planning where to locate certain agencies in communities prior to initiating the leasing process.

Comment: FLS will increase efforts immediately to identify and work with communities and legislators prior to initiating the leasing process for areas. However, great care must be exercised to avoid undue influence on the selection and evaluation process.

William D. Miller, CIA
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- 2.1 Clarify and strengthen its policies to ensure that leasing officials have adequate criteria to determine what can be included in lease agreements.
- 2.2 Consistently follow policies and not allow unique requirements and major renovations to be funded through leases.

Comment: DFM agrees with the recommendations, except it is believed the funding for special agency requirements should be a separate section within the leasing budget request rather than incorporated into the agency's operating budget. The inclusion of these funds in the leasing budget will enable DFM to better ensure that the items are appropriate, priced reasonably, correctly installed, and paid in a timely manner.

In conjunction with the Division of Budget and Planning, DFM plans to utilize our boilerplate office specifications as the criteria for the base rental rate, and any agency requirements that deviate from the basic specifications will be incorporated in a separate section of the leasing budget request as a one-time decision item. Attached is an outline of the process and the timeframe for implementation.

- 3.1 The General Assembly consider establishing a policy that requires agencies, when seeking office space, to make an effort to obtain bids in urban areas unless there is a compelling reason for locating elsewhere, or maintain documentation that effort was made to negotiate space in urban areas in those instances where bids were appropriately not sought.

Comment: This recommendation will be explored with the new administration and the Joint Committee on Capital Improvements and Leases Oversight.

We look forward to receiving your final report.

LA:rr

Attachment

Leasing- HB13

Agency Special Requirements Process

Definition: Any facility item, renovation or enhancement to a leased facility as requested by the tenant agency to support program delivery. Typically these items are in addition to the standard facility specifications and are included in the "Attachment C" of the R.F.P.

Process

1. Identify Needs

- Agency will determine special requirements as needed for each expiring lease location for the upcoming 2-year biennium cycle.

2. Prepare, submit and present Budget Request

- Agencies will be responsible for preparing the Form 5 and submitting budget requests for each location requiring a special requirement.
- Agencies will be required to present request(s) to Budget & Planning during the biennium leasing budget meeting.
- Agencies will be responsible for entering the information in BRASS
- All funding for agency special requirements must be requested in a separate section within HB13 and will not be included in the base rent.
- Agencies will be responsible for presenting the budget request for the special requirements to the General Assembly during the HB13 appropriations hearings.

3. Approval of Appropriation

- All approved funds will be appropriated within HB13.
- Upon approval of funding, the agencies will be responsible for setting priorities for expenditures by location within the total allocated funds.
- DFM will provide project coordination.
- DFM will process one time payment from HB13 to landlord when project is completed.
- DFM will track all payments from the appropriation and one-time payments for agencies may not exceed the total appropriation.

4. One-time payments from Operating Funds

- If funds are not available in HB13, agencies may use operating funds for special requirements or renovations required for program delivery.

FY01 Expiring leases

- Currently there are several locations where agencies have requested special requirements or renovations to support program issues. Each location will have to be reviewed on a case by case basis to determine if it is cost effective to include the agency special requirements.
- Agency operating funds may be used to provide the special requirements or requested renovations.

FY02 and FY03

- Budget requests for HB13 will be adjusted to include the section for "Agency special requirements."
- Agencies will be required to submit budget requests for special requirements by expiring lease location to DFM and Budget & Planning prior to December 15, 2000.

FY04 & FY05

- See process shown above.